IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 22225

JOHN J. McMULLEN ASSOCIATES, INC., *Appellant,*

v.

STATE BOARD OF HIGHER EDUCATION, ET AL., *Appellees.*

Appeal From the United States District Court for the District of Oregon
Honorable William T. Beeks, District Judge

REPLY BRIEF FOR APPELLANT

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SUPPLEMENTAL FACTUAL STATEMENT

As emphasized at the outset in appellant's principal brief, there is no dispute as to the facts in this case. However, because of implications in appellees' brief, clarification of certain facts might be helpful.

1. Design and Installation of Infringing Stabilizing Tank in the YAQUINA Was Without Assistance of Federal Government

The factual circumstances respecting the intention of the Navy Department to contract with Mr. John Leiby of Woods Hole Oceanographic Institute for the design of the infringing tank are set forth in some detail in appellees'

brief. By implication, appellees' brief (pages 74-79) suggests that the design and subsequent installation was carried out through the Navy Department.

Dealings between the Navy Department and Woods Hole took place in the fall of 1963. In December of 1963, responsive to a specific inquiry by appellant, the United States Navy Department, in the person of Admiral Brown, Assistant Chief of the Bureau of Ships, wrote a letter (PT Order, Agreed Fact 23, CT 102) categorically denying Navy participation and advising appellant that the work being performed by Oregon State University (OSU) concerning the YAQUINA was outside the scope of any Government rights and, therefore, a private job. The record shows that the effect of this letter was to put to rest any plan of the Navy Department to pay for the design.

Following Admiral Brown's letter, both Woods Hole Oceanographic Institute and the Navy Department refused to do the design work (RT 143). Ultimately, a stablizer was prepared by Mr. George Nickum, naval architect with offices in Seattle, Washington, acting under a patent infringement indemnity agreement with OSU (PT Order, Agreed Fact 30, CT 102; RT 142).

2. Appellant's Price Quotation to Appellee

The major portion of the quoted price of $24,500 (Ex. 461) covered (a) design of a passive tank stabilizer suitable for the YAQUINA, (b) contract plans and specification, (c) a full testing program at a model basin, (d) a technical report, (e) supervision of construction at the shipyard, and (f) sea trials, including shipboard instrumentation. The minor portion of the quoted price constituted a royalty for the use of the patented inventions.

A misconception seems to have been created by appellees' brief concerning use by OSU of the grant funds to obtain the professional services of the appellant. No prohibition existed against OSU's using funds for professional services.

The record reflects two prior instances concerning the same subject matter. The Woods Hole Oceanographic Institute, using grant funds, constructed an oceanographic ship, the ATLANTIS, incorporating a passive tank stabilizer according to the subject inventions (RT 145, 147). Following inquiry by appellant, a license royalty was paid to appellant for use of the patented inventions.

In a second instance, Texas A&M obtained an FS hull (now the ALAMINOS) similar to the YAQUINA and converted same with grant funds (RT 145; CT 133, Exs. 1030, 1031, 1032, 1033, 1035). Texas A&M contracted with appellant for the professional services outlined above and paid a royalty for use of the inventions.

3. Reports Given to NSF

The only reports given by OSU to NSF to meet its obligation under the grant have been bound volumes of reprints of scientific articles already published in standard technical periodicals or journals. According to the record, no special reports were prepared for NSF (CT 137, Exs. 1099, 1100, 1101).

4. NSF Grant Was Subject to a Pamphlet Entitled Grants for Scientific Research

The pamphlet entitled *Grants for Scientific Research* stated terms and conditions of the grant and was incorporated by reference into the grant letter itself (CT 139, Ex. 1171). On page 25 of the pamphlet, under the title "Safety Precautions", the following text appears:

> "As National Science Foundation research grants are made to provide financial support to grantees in their research undertakings, the *Foundation cannot assume any liability with respect to accidents, illnesses, or claims arising out of any work undertaken with the assistance of the grant.* The grantee institution is advised to take such steps to insure or protect itself as it may deem desirable." [Emphasis added]

5. Effectiveness of Stabilization System Never Proven

According to the record, the stabilization system was calculated by Mr. Nickum but never tested by Mr. Nickum to determine its efficiency or effectiveness (CT 137, Ex. 1115). On the basis of a blueprint provided by Mr. Nickum, Albina Engine & Machine Works constructed the stabilizer system. When the ship was put into service, the stabilizer system was tried once or twice, but the results, according to Marine Superintendent Rittenhouse, were totally inconclusive, and the decision was made to convert the tank to fresh water storage (CT 138, Ex. 1122).

From the fall of 1964 until late summer 1966, the stabilizer was never utilized as such. During this period, the ship performed its assigned tasks efficiently and effectively. The stabilizer system was activated in August of 1966, according to the testimony of Dr. Burt at the trial (RT 103), but its effectiveness or efficiency never was demonstrated or proven by any evidence introduced at the trial.

ARGUMENT

From the principal briefs, the focal issues in the case can be distilled as follows:

1. There is a material distinction between a Government contract and a Government grant.

2. Grantees' expenditures of NSF grant funds are not "for the Government [United States]" within the meaning of § 1498.

1. There Is a Material Distinction Between a Government Contract and a Government Grant

Appellees argue on page 44 of their brief that no distinction exists between a grant and a contract and that a grant is as much procurement as is a contract.

The position taken by appellees in their brief is totally inconsistent with legislative action by Congress and ig-

nores legal distinctions which intrinsically distinguish a contract from a grant. First and foremost, the grant represents the giving away of property or the conferring of a special right or privilege. *Only Congress, acting under its Constitutional authority, can make a grant.* This principle is well recognized and was heartily endorsed by the Comptroller General of the United States in his opinion to the Secretary of State, reported at 42 Comp. Gen. 289 (B-149441) (1962):

> "There can be no doubt that only the Congress is legally empowered to give away the property or money of the United States, and that when it makes grants of funds to the States and other public or private agencies it has a right to designate the purpose thereof and to surround the grant by such conditions as it chooses to impose. *State of Indiana* v. *Ewing*, 99 F. Supp. 734, cause remanded 195 F.2d 556. * * *" (at page 293)

The *State of Indiana* v. *Ewing* case referred to above was decided in the United States District Court for the District of Columbia by Judge Holtzoff who enunciated the indisputable principle that when the Federal Government makes grants to the states for specified purposes it has the right to surround the grants by such conditions as it chooses to impose. The fact that a grant is surrounded by conditions does not make it any less a grant.

The National Science Foundation Act states in § 1862 that the Foundation is authorized and directed to initiate and support basic scientific research by making contracts or other arrangements. Other arrangements are stated to include grants, loans, and other forms of assistance. Section 1870 states the general authority of the Foundation as including entering into contracts or other arrangements respecting basic scientific research activities and disposing by grant, sale, lease, or loan real or personal property necessary for or resulting from the exercise of authority granted by this Chapter.

The law applicable to grants was announced by the Supreme Court in the decision of *King County* v. *Seattle School District No. 1,* 263 U.S. 361, 68 L.Ed. 339 (1923). In that case, the Court had before it the precise question at bar, what are the limitations and restrictions upon a grantee's use of grant funds. The particular funds, money received from forest reserves, were granted by Act of Congress to the several states to be expended as the state legislatures prescribed for the benefit of the public schools and public roads of the counties in which the forest reserves were situated. For certain years, money granted to King County via the State of Washington was divided approximately 90% for roads and 10% for county schools. The school board charged that the county was obligated by the grant to divide the money equally for the two uses. The Court decided in favor of the county.

The following language from the decision is of significance to the present factual circumstances:

> "When turned over to the state, the money belongs to it absolutely. There is no limitation upon the power of the legislature to prescribe how the expenditures shall be made for the purposes stated, though, by the act of Congress, 'there is a sacred obligation imposed on its public faith.' Cooper v. Roberts, 18 How. 173, 181, 15 L.ed. 338, 341; Alabama v. Schmidt. 232 U.S. 168, 173, 58 L.ed. 555, 558, 34 Sup. Ct. Rep. 301; Mills County v. Burlington & M. River R. Co. 107 U.S. 557, 566, 27 L.ed. 578, 581, 2 Sup. Ct. Rep. 654; Hagar v. Reclamation Dist. 111 U.S. 701, 713, 28 L.ed. 569, 574, 4 Sup. Ct. Rep. 663. * * * The public schools and public roads are provided and maintained by the state or its subdivisions, and the moneys granted by the United States are assets in the hands of the state, to be used for the specified purposes as it deems best. See State ex rel. Moore v. Callvert, 34 Wash. 58, 61, 74 Pac. 1018." (at pages 364-365)

Two opinions of the Comptroller General are of assistance in firming up an understanding of the principle that grant funds when receipted by the grantee lose their

identity as Federal funds, and the grantee is under no obligation or restriction concerning Federal statutes which otherwise apply to the expenditure of Federal funds, such as contract funds. In his unpublished opinion B-145140, dated May 3, 1961, the Comptroller General advised the International Boiler Works Co. of East Stroudsburg, Pennsylvania, that the Federal Government could not act upon its protest concerning specifications covering high temperature water boilers used in P.H.A. Aided Project No. Ill-2-37, Stage III, Chicago, Illinois. The following two quotations from the Comptroller General's opinion reveal the reasons for the Federal Government's nonparticipation in the program, despite origination of the funds with the Federal Government:

> "The report points out that the Federal Government is not a party to the general construction contract between the Chicago Housing Authority and the Gust K. Newburg Construction Company. Our Office has recognized that the low-rent housing program, although assisted by Federal subsidies, is essentially a local program. See our decision B-126528, dated February 17, 1956, a copy of which is enclosed. The Chicago Housing Authority is not an agency of the Federal Government, but is separate and apart and is not subject to Section 3709 of the Revised Statutes, as amended, or other statutes which require advertising for bids.
>
> * * * * * * * * *
>
> "In an analogous situation involving a protest against specifications allegedly favoring one manufacturer for elevators to be used in a hospital project involving Federal assistance funds, we held in decision B-141932, dated May 2, 1960, that it was the duty of the Surgeon General to determine compliance with the regulations imposed by him, and no action by our Office was warranted after the Surgeon General had approved the specifications."

The latter quotation again touches on the proposition that where conditions are attached to a grant, the Federal Government's sole obligation is to determine compliance

with such conditions. The presence of conditions does not destroy the character of the grant, nor transform it into a Government contract.

Perhaps even more pertinent is the decision of the Comptroller General reported at 37 Comp. Gen. 85 (B-132417) (1957) to the Secretary of Agriculture holding that a sales tax can be paid on purchases made with Federally-derived grant funds. Note the following excerpt from the opinion:

> "The first question here is whether the States, in obligating and disbursing the funds granted to them by Congress for cooperative agricultural extension work and experiment station research, stand in such relationship to the Government that purchases by a State become, in legal effect, purchases by the United States. If such a relationship exists or, in other words, if the funds so granted must continue to be regarded as Federal funds until disbursed by the State officials, who in that case would be acting as agents of the United States, then it follows that payment of State sales taxes, the legal incidence of which is on the purchaser, would violate the Constitutional immunity of the United States against State and local taxation.
>
> "The general rule regarding the character and status of such funds is stated in 28 Comp. Gen. 54 as follows:
>
> > '* * * it consistently has been held with respect to Federal funds granted to a State that, when such funds are receipted for by the State, they become State funds and, in the absence of a condition of the grant specifically prescribing to the contrary, are totally divested of their identity as Federal funds and become funds of the State and the expenditure thereof is subject to the laws and regulations applicable to the expenditure of State funds rather than by Federal laws applicable to the expenditure of appropriated moneys by the departments and establishments of the Government.'
>
> "That this rule is applicable to grants for agricultural extension work and for the work carried on by State agricultural experiment stations seems apparent from the language of the controlling statutes.

7 U.S.C. 341-348; 361-389, Supp. IV. *Cf.* 25 Comp. Gen. 868 and 36 Comp. Gen. 84.

> "The States, therefore, in disbursing grant funds for purposes within the scope of the grant, may not be considered as 'agents' of the United States; and, except for conditions specified by Congress in the grants, they are subject only to the restrictions imposed by State laws and regulations on the disbursement of other State funds. If a State, under its laws, is required to pay sales taxes on purchases made with funds derived from State revenues, we can see no reasonable basis for holding that such sales taxes may not likewise apply to purchases with funds obtained by the State through a Federal grant, provided the terms of the grant do not expressly prohibit the payment of such taxes." (at pages 86 and 87)

In view of this authority, recipients of grant funds from the National Science Foundation are *not obligated* to follow Title 41 U.S.C. § 5, requiring advertising, competitive bidding, and compliance with the general laws, as implied by appellees. Nor is the grantee subject to supervision by the General Accounting Office or any of the restrictions or limitations stated in Federal statutes, including the Federal Procurement Regulations (Title 41 C.F.R.) and the ASPR Regulations (Title 32 C.F.R., Chap. 1, Subchap. A, Parts 1-30). A Government contractor is subject to all of the foregoing (41 U.S.C., Chap. 4, §§ 251-260, and 10 U.S.C., Chap. 137, §§ 2301-2314).

In contradistinction to what has been stated above with respect to grants and the fact that they must emanate from Congress, contracts occupy an entirely different legal status. The contract is the conventional legal form used by the various agencies of the Federal Government to procure goods and services necessary to carry out their normal functions. As such, the procurement of, or contracting for, goods and services is subject to all Federal statutory requirements, restrictions, limitations, and obligations.

The essence of the distinction between a grant and a contract is perhaps best illustrated by the decision of the Comptroller General reported at 43 Comp. Gen. 697 (B-153348) (1964). This decision was addressed to The Honorable Leland J. Haworth, Director, National Science Foundation, and the specific questions presented for the Comptroller General's decision were: (1) Whether expenditures may be made from NSF research grants supporting research at nonprofit institutions for the purchase, maintenance, or operation of aircraft where required to conduct the reserach for which the grant has been made, or (2) whether the Foundation may reimburse a cost contractor operating a Federally-owned research center for costs incurred by the contractor in obtaining the use of the aircraft necessary to carry out research activities at the center.

The particular Federal statute involved was 5 U.S.C. § 78(b) [now 31 U.S.C. § 638a(b)]:

> "Excepting appropriations for the Military and Naval Establishments, no appropriation shall be available for the purchase, maintenance, or operation of any aircraft unless specific authority for the purchase, maintenance, or operation thereof has been or is provided in such appropriation."

The Comptroller General reached the conclusion that the grantee may buy the aircraft, since the expenditure of grant funds is not subject to the restrictions and limitations imposed by Federal statute:

> "Whether the restriction contained in 5 U.S.C. 78(b), quoted above, applies to expenditures made by a grantee from funds granted by the Foundation for the conduct of basic research, will depend of course on the terms and conditions of the particular grant. It consistently has been held with reference to Federal grant funds that, when such funds are granted to and accepted by the grantee, the expenditure of such funds by the grantee for the purposes and objects for which made are not subject to the

various restrictions and limitations imposed by Federal statute or our decisions with respect to the expenditure, by Federal departments and establishments, of appropriated moneys in the absence of a condition of the grant specifically provided to the contrary. See 36 Comp. Gen. 221, 224 and decisions cited therein.

"Since the funds appropriated for the National Science Foundation are made available for expenses necessary to initiate and support basic scientific research, and since the Foundation is authorized to accomplish this purpose by various methods, including grants, it follows that the rule set forth above with reference to the expenditure of grant funds by the grantee would appear equally applicable to grants made by the Foundation for basic scientific research. Consequently, if expenditures for the purchase, maintenance or operation of aircraft are administratively determined to be required for the effective accomplishment of the purpose or objects for which a research grant is made, no objection will be interposed thereto solely by reason of the restrictive provisions of 5 U.S.C. 78(b), which for the reasons stated here have no application to such research grants. The first question presented is answered accordingly." (at pages 699 and 700)

By the same token, the Comptroller General reached the opposite conclusion with respect to reimbursement of the contractor operating the Federally-owned research center, because the statutory restrictive provisions of 5 U.S.C. § 78(b) applied to him.

2. Grantees' Expenditures of NSF Grant Funds Are Not "for the Government [United States]" Within the Meaning of § 1498

Based on the foregoing, the restrictive provision of § 1498 has no application to NSF research. Once grant funds are receipted by the State, they belong to it absolutely (*King County* v. *Stattle School District No. 1, supra*) subject only to the conditions imposed by the grant (*State of Indiana* v. *Ewing, supra*). No clear statement is found in the subject grant (Exs. 1143, 1144) or in the statutory

authority for it (42 U.S.C. §§ 1862 and 1870) making the restrictions of 28 U.S.C. § 1498 applicable.

Also, a fair construction of § 1498 limits its applicability to Government contracts to procure goods or services to carry out Government functions.

Congress intended by the 1910 Act to give a patentee a remedy where none previously existed, namely, to sue the Federal Government for unauthorized use of his invention. Notwithstanding, however, the patentee had been and continued to be free to proceed against the Government contractor.

Congress intended by the 1918 Act to prevent interference with Government contracts in the light of the needs of wartime procurement (WW I). As a result, the patentee lost his right to proceed against the contractor.

Congress intended by the 1942 Royalty Adjustment Act to narrow the Government's liability under the 1918 Act to only those instances of procurement where it had authorized and consented to use of the patentee's invention. Again, wartime (WW II) had necessitated a change.

Since 1942, no substantial amendment has been made to § 1498. In the meantime, utilization of legislative grants for basic research has become prevalent. As noted in appellees' brief on page 45, before 1958 only three agencies were authorized by Congress to make grants, and one of these, NSF, was created in 1950.

Did Congress, before or after 1958, intend that its legislative grants authorized for basic scientific research be subject to the restriction of 28 U.S.C. § 1498?

The courts have noted often Congress' ability to express itself clearly and unambiguously regarding conditions of a grant. In the absence of such an expression regarding § 1498, one must believe that the restrictions of § 1498, like other Federal statutory provisions, do not apply to legislative grants.

CONCLUSION

If problems exist regarding legislative grants and patentees, then perhaps the time has arrived for Congress to reconsider § 1498 and determine whether amendments are necessary or desirable, but this is a legislative function and should be left where it properly belongs.

Respectfully submitted,

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I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.
